Internal Revenue Service

memorandum

CC:NER:BRK:TL-N-4606-98
AJMandell

date: FEB - 3 1999

to: District Director, Brooklyn
Chief, Examination Division
Attn: Vincent Marcantonio, RA

from: District Counsel, Brooklyn

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subject: [redacted]
U.I.L. 367.03-00; 368.00-00; 6501.08-00

THIS DOCUMENT MAY INCLUDE CONFIDENTIAL INFORMATION SUBJECT TO THE ATTORNEY-CLIENT AND DELIBERATE PROCESS PRIVILEGES, AND MAY ALSO HAVE BEEN PREPARED IN ANTICIPATION OF LITIGATION. THIS DOCUMENT SHOULD NOT BE DISCLOSED TO ANYONE OUTSIDE THE IRS, INCLUDING THE TAXPAYER INVOLVED, AND ITS USE WITHIN THE IRS SHOULD BE LIMITED TO THOSE WITH A NEED TO REVIEW THE DOCUMENT IN RELATION TO THE MATTER OF THE CASE DISCUSSED HEREIN. THIS DOCUMENT IS ALSO TAX INFORMATION OF THE INSTANT TAXPAYER WHICH IS SUBJECT TO I.R.C. § 6103.

Reference is made to the memorandum dated December 14, 1998 supplied in response to your request regarding whether the statute of limitations for [redacted]'s tax return for the fiscal year ending November 30, [redacted] was properly extended, and whether the transaction in which [redacted] transferred his stock in [redacted] into [redacted] in an I.R.C. section 351 transfer should be disregarded based on a lack of business purpose.

We stated in the memorandum that it was being referred to the National Office for review, that the review might result in modifications to the advice rendered therein, and that we would inform you of the results of the review.

The memorandum was reviewed by subject matter specialists in the National Office who indicated that they agreed with the advice rendered therein.

Please contact Andrew Mandell at (516) 688-1701 if we may be of further assistance.

DONALD SCHWARTZ
District Counsel
Brooklyn

By: ______________________
ANDREW J. MANDELL
Attorney

Internal Revenue Service

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Issues:

1. Whether the statute of limitations for [redacted]'s tax return for the fiscal year ending November 30, [redacted] was properly extended?

2. Whether the transaction in which [redacted] transferred his stock in [redacted] into [redacted] in an I.R.C. section 351 transfer should be disregarded based on a lack of business purpose?

   a. Whether disregarding the section 351 transfer will have any effect on whether the taxpayer is entitled to nonrecognition treatment?

Facts:

The facts, as we understand them are as follows:

In [redacted], [redacted] (hereinafter [redacted]) was part of an I.R.C. section 368(a)(1)(A) merger in which four related corporations, [redacted]; [redacted]; [redacted]; and [redacted] were merged into [redacted] which was the surviving corporation.[1] The corporation was involved in the [redacted] industry.

[redacted] (hereinafter the taxpayer) was interested in obtaining stock ownership in a related foreign corporation, [redacted], which is located in [redacted] and is also involved in the [redacted] industry.

It was believed that the taxpayer's attorney advised him against exchanging his [redacted] stock for stock of [redacted] because as an individual taxpayer this would be a taxable exchange.[2] Therefore, on [redacted] the taxpayer, pursuant to a section 351 transfer, transferred his [redacted] stock to [redacted] On [redacted], [redacted], the sole corporate owner of [redacted] stock, exchanged the [redacted] stock for stock in [redacted], receiving [redacted] shares of [redacted] stock valued at $[redacted] The [redacted] stock had a basis of $[redacted]. [redacted] treated this as a tax free exchange pursuant to I.R.C. section 367 on its corporate income tax return for the fiscal year ending November 30, [redacted].[3]

[redacted] attached a Form 926, Return by a U.S. Transferor of Property to a Foreign Corporation, Foreign Estate or Trust, or Foreign Partnership, to its return for the fiscal year ending November 30, [redacted]. A rider to the Form 926 states that the transferor agrees to waive the period of limitation on assessment of tax upon the gain realized on the transfer pursuant to Treas. Reg. section 1.367(a)-3T(g)(4). The rider went on to state that the transferor also agrees to file with its income tax return for each of the eight taxable years following the taxable year of the transfer a waiver of the period of limitations on assessment as described in Treas. Reg. section 1.367(a)-3T(g)(4).

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[1]All [redacted] C-corporations were owned solely by an individual, [redacted], who owned [redacted]% of the surviving corporation.

[2]The taxpayer stated, in a memorandum dated [redacted], that the purpose of creating [redacted] was to facilitate the transfer of [redacted] to [redacted] while the taxpayer retained other business interests owned or controlled by it.

[3]This was the initial return filed by [redacted].

In accordance with the agreement set forth in the rider, a Form 872 was apparently attached to the return. The front page of the Form 872 revealed that the period for assessment of the tax for the fiscal year ending October 31, [redacted] was extended until October 31, [redacted].

Discussion:

Issue 1.

Treas. Reg. section 1.367(a)-3 provides rules concerning the transfer of stock or securities by a U.S. person[1] to a foreign corporation in an exchange described in section 367(a). In essence, a transfer of stock or securities by a U.S. person to a foreign corporation that is described in section 351, 354 (including a reorganization described in section 368(a)(1)(B)), 356 or 361(a) or (b) is subject to section 367(a)(1) and, therefore, is treated as a taxable exchange, unless the transfer is subject to one of the exceptions set forth in the regulations. Treas. Reg. section 1.367(a)-3.

Treas. Reg. section 1.367(a)-3(g)(1) provides transition rules regarding transfers of domestic stock after December 16, 1987 and prior to July 20, 1998. Transfers within the transition period are subject to the rules contained in section 367(a) and the regulations thereunder, as modified by the rules contained in paragraph section 1.367(a)-3(g)(2).

Treas. Reg. section 1.367(a)-3(g)(2)(ii) provides in pertinent part that a U.S. transferor that transfers domestic stock in an exchange described in section 367(a) and owns at least 5 percent of either the total voting power or the total value of the stock of the transferee foreign corporation immediately after the transfer may qualify for nonrecognition treatment by filing a gain recognition agreement in accordance with section 1.367(a)-3T(g) for a duration of 5 or 10 years.

Treas. Reg. section 1.367(a)-3T(g) provides that a transfer of stock shall not be subject to section 367(a)(1) if the transferor complies with the reporting requirements of section 6038B and the transferor files a binding agreement to

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[1]The term "United States person" includes a citizen or resident of the United States, a domestic partnership, a domestic corporation and any estate or trust other than a foreign estate or trust. Treas. Reg. section 1.367(a)-1T(d)(1).

recognize gain upon the transferee corporation's later disposition of the transferred stock.

The transferor's agreement to recognize gain must be attached to, and filed with the tax return. The agreement must be signed by a responsible officer of the corporation. The agreement must contain the following: (1) a statement that the document submitted constitutes the transferor's agreement to recognize gain; (2) a description of the stock or securities transferred; an estimate of fair market value as of the date of transfer; and a statement of cost or other basis and any adjustments thereto; (3) the transferor's agreement to recognize gain; (4) a waiver of the period of limitations[5], and (5) an agreement to file with the transferor's tax returns for the 5 years following the year of the transfer a certification and waiver.[6] Treas. Reg. section 1.367(a)-3T(g)(2).

There does not appear to be any dispute that the corporation complied with the agreement to recognize gain as shown by the attachment (Rider to Form 926) to the return for the fiscal year ending November 30, [redacted]. As stated above, with regard to the fourth requisite, the attachment states that

> [t]he transferor agrees to waive the period of limitation on assessment of tax upon the gain realized on the transfer pursuant to Reg. 1.367-3T(g)(4). In accordance with this requirement Form 872 is attached.

However, the Form 872, which is part of the Rider to Form 926, extends the period on assessment for the fiscal year ending October 31, [redacted] and not November 30, [redacted]

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[5]The transferor must file a waiver of the period of limitation on assessment of tax upon the gain realized on the transfer. The waiver shall be on such forms as are prescribed by the Commissioner and shall extend the period for assessment of such tax to a date not earlier than the close of the eighth taxable year following the taxable year of the transfer. Treas. Reg. section 1.367(a)-3T(g)(4).

[6]The certification must state that the stock transferred has not been disposed of by the transferee in a transaction that is considered a disposition. Treas. Reg. section 1.367(a)-3T(g)(5).

It appears, based on the facts available to us, that the parties intended to extend the statute of limitations for the fiscal year ending November 30, [redacted]. The Form 872 was attached to the return for the fiscal year ending November 30, [redacted], and the corporation's intent was to comply with the section 367 regulations which required it to extend the statute of limitations for the fiscal year ending November 30, [redacted]. In addition, the corporation has a fiscal year ending November 30th and not October 31st.

I.R.C. section 6501 provides that respondent may assess deficiencies in income taxes within 3 years after the due date of a timely filed return.[7] Section 6501(c)(4) allows a taxpayer and respondent to consent in writing to extend the period for assessment.

A consent extending respondent's time to assess taxes is not a contract. However, contract principles are significant because section 6501(c)(4) requires that the parties reach a written agreement as to the extension. Piarulle v. Commissioner, 80 T.C. 1035, 1042 (1983). The term agreement means a manifestation of mutual assent. It is the objective manifestation of mutual assent as evidenced by the parties' overt acts that determines whether the parties have made an agreement. Kronish v. Commissioner, 90 T.C. 684, 693 (1988).

The courts distinguish between a consent that is ambiguous, and a consent in which there has been a mutual mistake. If an ambiguity exists in a written extension the court will admit extrinsic evidence to clarify the ambiguity and to determine the parties' intent. The extension will then be interpreted in accordance with the parties' intent. Constitution Publishing Co. v. Commissioner, 22 B.T.A. 426 (1931).

A written instrument is ambiguous if it can reasonably be interpreted to have more than one meaning. Sawyer v. Commissioner, T.C. Memo. 1988-132. A written extension is not ambiguous when it is clear on its face and its meaning is certain, even though it misstates the intent of both parties. Constitution Publishing Co. v. Commissioner, supra, at 427.

The Form 872 in the instant case is not ambiguous. It clearly extends the period for assessment for the fiscal year ending October 31, [redacted]. This is more properly characterized

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[7] Although we only have the front page of the Form 872, we are assuming that the extension was signed by the parties within 3 years of the filing of the return at issue.

as a mutual mistake which exists where there has been a meeting of the minds of the parties and an agreement actually entered into, but the agreement in its written form does not express what was really intended by the parties. Woods v. Commissioner, 92 T.C. 776 (1989).

Where a written agreement does not conform with the actual agreement between the parties, a court may reform the writing to conform with the parties intentions. Reformation is an equitable remedy used to reframe written contracts to reflect the real agreement between the parties when, because of mutual mistake, the writing does not embody the contract as actually made. Rocanville Corp. v. Natural Gas Pipeline Co., 823 F.2d 92, 94 (5th Cir. 1987).

The Tax Court has held that it cannot expand its jurisdiction by giving equitable relief from statutorily prescribed jurisdiction requirements. Knapp v. Commissioner, 90 T.C. 430, 440 (1988), aff'd, 867 F.2d 749 (2d Cir. 1989); Estate of Rosenberg v. Commissioner, 73 T.C. 1014, 1017-1018 (1980). The Tax Court has, however, distinguished between the application of equitable principles to decide a matter over which it had jurisdiction and the exercise of "general equitable powers" to take jurisdiction over a matter not provided for by statute. Woods v. Commissioner, 92 T.C. 776 (1989).

The Tax Court has jurisdiction to determine whether a deficiency exists and, in so doing, must determine the efficacy of the Form 872. In so doing, it may apply equitable principles. Woods v. Commissioner, 92 T.C. 776.

It appears that based on the facts of this case, the Tax Court would reform the written instrument to conform to the agreement and intent of the parties. The evidence is clear and convincing that the parties intended to extend the period of limitations with respect to the fiscal year ending November 30, [redacted].

We do not believe that the mere fact that the mistake in the written extension originated with the Service precludes a reformation. The corporation, who was actually involved in the transaction, was also mistaken when it signed the document. The circumstances of this case do not appear to warrant withholding relief from a mistake. The mere fact that the party seeking relief did not exercise reasonable care should not preclude reformation. Woods v. Commissioner, 92 T.C. 776.

Issue 2.

As discussed above, Treas. Reg. section 1.367(a)-3 provides, in essence, that a transfer of stock or securities by a U.S. person to a foreign corporation that is described in section 351, 354 (including a reorganization described in section 368(a)(1)(B)), 356 or 361(a) or (b) is subject to section 367(a)(1) and, therefore, is treated as a taxable exchange, unless the transfer is subject to one of the exceptions set forth in the regulations.

There does not appear to be any dispute, and we have therefore assumed for purposes of this advice, that the transaction, as set up by the taxpayer, if accepted, qualifies for nonrecognition treatment. The taxpayer transferred his stock in [redacted] to [redacted] in a section 351 transfer. It is your belief that only corporations can exchange stock using the reorganization provisions of section 368. It was concluded that the section 351 transfer of stock to [redacted] was done only so that the subsequent transfer of stock to the foreign corporation would be considered a reorganization pursuant to section 368(a)(1)(B)[3].

It is your belief that there was no business purpose in forming [redacted] and that the corporation was formed solely to allow the taxpayer to take advantage of the reorganization provisions. The issue, therefore, that you posed to our office is whether using a sham transaction theory or the step transaction doctrine we could disregard the corporation and treat this transaction as the sale by the taxpayer of [redacted] stock for [redacted] stock.

We do not believe, based on the facts as we understand them, that it is necessary to determine whether there was a valid business purpose in forming [redacted], or whether the corporation was a sham, for the purpose of disregarding the corporation. Assuming that the transaction, as set up by the taxpayer, was a valid section 368(a)(1)(B) reorganization and that nonrecognition treatment was appropriate after applying the regulations under section 367, then we believe that even if the corporation is disregarded, nonrecognition treatment would still be appropriate.

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[3] Reorganization under section 368(a)(1)(B) means the acquisition by one corporation, in exchange solely for all or a part of its voting stock, of stock of another corporation if, immediately after the acquisition, the acquiring corporation has control of such other corporation.

There is nothing in the code or regulations that states that only corporations can exchange stock using the reorganization provisions of section 368(a)(1)(B). Section 368 only requires that one corporation (in this case [redacted]) in exchange solely for all or part of its voting stock, acquires stock of another corporation (the [redacted] stock) if immediately after the acquisition, the acquiring corporation has control of such other corporation. There is nothing that prohibits the [redacted] stock from being exchanged by the taxpayer as opposed to [redacted].[3] Therefore, because an individual can transfer stock to a corporation in a section 368(a)(1)(B) reorganization, collapsing the corporation will not effect the validity of the reorganization.

CONCLUSION

Based on the facts discussed above, it appears that both parties intended to extend the statute of limitations for the fiscal year ending November 30, [redacted], that there was a mutual mistake, and that a viable argument can be made that the Tax Court may apply equitable principles and reform the written instrument to conform to the agreement and intent of the parties.

Because individuals as well as corporations can transfer stock to a corporation in a section 368(a)(1)(B) reorganization, we also believe that, assuming that all of the requirements for nonrecognition treatment are otherwise met, collapsing the corporation will have no effect on nonrecognition treatment.

This opinion is based upon the facts set forth herein. You should be aware that, under routine procedures which have been established for opinions of this type, we have referred this memorandum to the Office of Chief Counsel for review. That review might result in modifications to the conclusions herein. We will inform you of the result of the review as soon as we hear from that office. In the meantime, the

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[3]The example used in Rev. Rul. 70-433, 1970-2 C.B. 82, confirms that individuals can transfer stock to a corporation in a section 368(a)(1)(B) reorganization. In the example, A, a United States citizen and resident owned all of the outstanding stock of X, a domestic corporation, and Y, a foreign corporation. For valid business reasons, X acquired all of the stock of Y from A solely in exchange for additional voting stock of X pursuant to a plan that met the requirements of a section 368(a)(1)(B) reorganization.

conclusions reached in this opinion should be considered to be only preliminary.

If you have any additional questions, please call the undersigned at (516) 688-1701.

DONALD SCHWARTZ
District Counsel
Brooklyn

By: [signature]
ANDREW J. MANDELL
Attorney